(12)

No. 92-854

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

CENTRAL BANK OF DENVER, N.A.,
Petitioner,

v.

FIRST INTERSTATE BANK OF DENVER, N.A. and
JACK K. NABER,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF FOR RESPONDENTS

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QUESTIONS PRESENTED

1. Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

2. Does recklessness satisfy the scienter requirement for aiding and abetting even where there is no breach of a duty to disclose or to act?

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STATEMENT OF THE CASE

Central Bank of Denver was Indenture Trustee for an $11 million bond issue known as the "Colorado Springs-Stetson Hills Public Building Authority Landowner Assessment Lien Bonds, Series 1988A" (the "1988 bonds"). First Interstate Bank of Denver, N.A. purchased $2,100,000 of the 1988 bonds, and resold some of them to its customers.[1] Joint Appendix ("J.A."), at 7. Respondents' Amended Complaint alleged that the 1988 bonds were marketed as part of a fraudulent scheme perpetrated by the developer of Stetson Hills, the crux of

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[1] Respondent Jack Naber, a customer of First Interstate, was initially proposed to the federal district court as a class action representative. When the court declined to certify a class, Mr. Naber continued in the case as an individual plaintiff.

which was to induce sales based on fraudulent assurances that the land pledged under an "assessment lien" as collateral for the bonds would continuously be worth 160% of the amount of the bonds, when in fact the collateral was deficient and the purportedly conservative appraisal of it was grossly inflated.[2]

Central Bank provided critical assistance to the fraudulent scheme by taking affirmative steps to ensure that the shortage of collateral and the defects of the appraisal would be hidden from plaintiffs and other potential purchasers, at least until well after the bonds had been sold to the public. J.A. 23-24. First Interstate's Amended Complaint alleged that Central took these steps knowingly or recklessly, and thereby aided and abetted the developer's fraud in violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1988 & Supp. III 1991), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1992). J.A. 24-26. As with other participants in the bond issue. Central Bank stood to profit from the offering. Central had already received fees for acting as trustee for the initial $24 million Stetson bond issue in 1986 (the "1986 bonds"), and in early 1988 was actively preparing to fulfill the same role for the 1988 issue. I R, Tab 12 at 6.

The inflated appraisal of the land pledged to the 1988 bonds was prepared by Joseph Hastings (the same appraiser who had two years earlier evaluated the collateral for the 1986 bonds, and who had also been accepted by Central for the 1988 issue). J.A. 52-53, 73. The combined appraisal document presented to Central Bank in

[2] Under the bond covenants, the "160% test" was to have been based on a "bulk sale," liquidation value appraisal. In the trial court, First Interstate retained an experienced MAI appraiser who evaluated the collateral for the 1988 bonds, using valid comparables and the methodology actually required by the bond covenants. The results showed that the appraisal which accompanied the 1988 issue was inflated by approximately 400 percent. Record on Appeal, Volume I ("I R"), Tab 5 at 2.

early 1988 covered both the 250 acres of Stetson Hills property securing the 1986 bonds, and the separate 272-acre parcel proposed to be pledged as security for the 1988 issue. J.A. 60-61. Central asked Hastings simply to separate this document into its 1986 and 1988 components, which he did. J.A. 61. His methodology in evaluating the collateral was the same, however, for all of the properties. J.A. 68.

Central Bank understood that the purpose of the appraisal was "to provide satisfactory evidence to the Trustee that the 160% test is being met." J.A. 76. When Hastings' methodology came under criticism, including from Central's own expert, a controversy arose which threatened to terminate the 1988 bond issue.

Cheryl Crandall, a Central Bank Corporate Trust Department officer, had been assigned responsibility for Central's duties related to the Stetson bonds. When she reviewed the appraisal early in 1988, she noticed that the values Hastings was then using were purportedly unchanged from the figures he had determined two years earlier. Crandall expected, she recalled, to "see some difference." J.A. 63. Such a difference would have been anticipated given declining property values in El Paso County. J.A. 63-64.

Central Bank also was aware of facts suggesting that bond investors might actually need to resort to the property pledged as security for the 1986 and 1988 bonds: in December 1987 Central had already been forced to draw from a bond reserve fund to make a year-end payment of $654,000 of principal and interest to the 1986 bondholders. J.A. 62-63; Crandall and Central knew that the lots in the Stetson development were not selling well enough to produce sufficient revenue to replenish the reserve fund. *Id.*

In late January, Crandall received a letter from Dain Bosworth, the investment banking firm which had served as lead underwriter for the 1986 bonds. Dain had not yet

seen Hastings' 1988 appraisal, but had serious misgivings about the adequacy of the bond collateral and believed the developer was violating the bond covenants:

> At this date we are operating on an appraisal that is over 16 months old. In light of the declining property values in Colorado Springs and the foreclosure sales, many of which have occurred within the vicinity of the collateral, *an appraisal that reflects property values similar to those utilized for the 1986 appraisal of record should be suspect* and not relied on without further independent check. As Trustee, you have the authority to name an independent appraisal [sic] if you are not satisfied.
>
> It appears that the officers of the Stetson Hills Building Authority have failed to conform to the Bond Covenants to which they agreed. *In the interest of the bondholders I call upon you to enforce the covenants or Invoke the Remedies . . . .*

J.A. 86 (emphasis added). In the letter, in addition to pointing out that the critical 160% test was "probably not being met" as to the 1986 bonds, Dain Bosworth specifically warned Central Bank of fraud by the developer: "The fact that property was released from the Lien of the Indenture without the appropriate amounts being placed in the Bond Fund would suggest that *you may have been given false or misleading certifications.*" J.A. 85-86 (emphasis supplied).

Crandall then independently calculated the 160% test on the collateral for the 1986 bonds. Her work confirmed that, as Dain Bosworth had feared, the value had already fallen below the 160% test, to 131%. J.A. 66.

By that time, Dain had received a copy of Hastings' appraisal of the 1988 bond collateral. On February 22, 1988, Dain sent another letter to Central Bank, this time pointedly criticizing the 1988 appraisal:

> Cannot believe that appraiser could not find comparable sales more recent than 1985 and 1986 when

> there were several foreclosure sales in 1987. *Using comparables that are tied to a more upbeat market tends to overstate the current value of the . . . collateral.* Even using the 1985 and 1986 comparables, it is hard to see how Hastings could have arrived at a $5 per square foot current value . . . .

J.A. 108 (emphasis added).

Central Bank had its own appraiser, Ed Elmer, whom it considered to be its "resident expert." J.A. 116. Central referred the Hastings evaluation to Elmer for his review. Elmer also spoke directly with Hastings.[3]

Elmer's review, and his conversation with Hastings, confirmed that the appraisal was inflated and unreliable and that, by Hastings' own admission, it did not conform to the liquidation value methodology required by the bond covenants. In a March 22, 1988 letter to the developer, Crandall summarized Elmer's conclusions and demanded that an independent review of the appraisal be done, and not by Mr. Hastings:

> Based upon our review, and the recommendation given us by Mr. Elmer, we will require, in our capacity as Trustee, that an independent review of the appraisal be conducted by a different appraiser . . . .
>
> We are requiring that an independent review of the appraisal be conducted for the following reasons:
>
> 1. The age of the comparable sales data makes it *of questionable use as a valid basis for valuation.* We question why more recent sales were not utilized for this purpose.
>
> 2. Mr. Hastings has confirmed that his discounting methods did not consider a bulk sale in a forced

[3] This was the only situation in which Central Bank had asked Mr. Elmer to review an appraisal of collateral for a bond issue. J.A. 210. Based on all of the facts, the Tenth Circuit concluded that, "the evidence supports the inference that this was not an ordinary transaction." *Id.*

liquidation context, as is specifically required by the Indenture.

3. Based on our review and investigation, the *values determined by the appraisal appear to be unjustifiably optimistic,* given the current economic conditions in the residential and commercial real estate markets in El Paso County.

J.A. 117 (emphasis added).

Within only a matter of days, however, after Crandall sent this letter, the head of Central Bank's Trust Department, Kenneth Buckius, took charge from Crandall of Central's duties related to the Stetson bonds. J.A. 69. On March 31, 1988, Buckius met with representatives of the developer and of the lead underwriter. The developer's representative, Greg Timm, proposed simply to go forward with the sale of the bonds, to use the inflated appraisal, and to put off an independent review until six months after the closing. Appraiser Hastings would be asked to sign off on a "certification letter." Central Bank's notes of the meeting reflect that Hastings would not be drafting the letter himself: "draft letter to see if Hastings can live with it." J.A. 119. The developer would contribute additional land to the collateral, but only for the 1986 issue, *not the 1988 bonds.* J.A. 45-50. The nonconforming methodology of Hastings' 1988 appraisal, resulting in what Central's expert termed "unjustifiably optimistic" values, remained uncorrected. J.A. 116-117, 122-123.

On May 13, 1988, Central Bank, by Kenneth Buckius, entered into a side agreement with the Stetson developer, permitting the 1988 bonds to be marketed under the Hastings appraisal, with the independent review to be postponed until December 1988, six months after the bonds were to be sold to the public. J.A. 124-125. Central Bank's essential role in the decision was noted: "Need to get Ken [Buckius of Central Bank] to go to [Central Bank] Trust Committee to buy off on Greg's offer." J.A. 118.

The Certification earlier drafted for Hastings was not executed by him until June 16, 1988, more than one month after Central Bank had already agreed with the developer to delay an independent review. J.A. 154. The Certification, which Central says it relied upon to satisfy its concerns about the appraisal, does not represent that the methodology required by the Indenture was used, but rather that the result was the same. J.A. 153, ¶ 5.

By the end of 1988, the risks to bond purchasers earlier flagged by Central's appraiser Ed Elmer had materialized. In April 1989, the holders of $26 million of Stetson Hills 1986 and 1988 bonds received letters from Central Bank (J.A. 20) disclosing, for the first time, that in December 1988 the developer had failed to supply the promised year-end appraisal of the 1988 bond collateral. That document was never forthcoming. By the summer of 1990, the reserve fund was depleted, and the 1988 bonds lapsed into monetary default. J.A. 20-21. It was then revealed to bondholders that the collateral had, after all, not been worth 160% of the bonds, but substantially less than even the bond principal.

In the trial court and in the Tenth Circuit, respondents showed that the evidence of Central Bank's extensive involvement in the issuance of the 1988 bonds, its receipt of credible warnings of fraud by the developer, its awareness of the magnitude of the risks to bond purchasers posed by an inflated appraisal, and its participation in a concealed side agreement with the developer to forego timely review of that appraisal, all gave rise at least to an inference of recklessness, if not of actual knowledge by Central Bank of the fraudulent scheme charged in the Amended Complaint.

In its opinion, the Tenth Circuit said that "Central Bank has mischaracterized plaintiffs' claim as one alleging that Central Bank improperly did not disclose certain facts . . . . But plaintiffs' claim against Central Bank is different. Plaintiffs allege that Central Bank assisted

the primary violation by *affirmative action*, specifically by affirmatively agreeing to delay the independent review of the Hastings appraisal." J.A. 207 (emphasis in original).[4] Reviewing in detail the factual background, the Tenth Circuit concluded that, "the bank's knowledge of the alleged inadequacies of the Hastings updated appraisal could support a finding of extreme departure from the standards of ordinary care," that plaintiffs had "established a genuine issue of material fact as to the scienter element of aiding-and-abetting liability," and that summary judgment in favor of Central Bank was not appropriate. J.A. 212-213.

SUMMARY OF ARGUMENT

On this appeal, petitioner seeks to overturn the Tenth Circuit's opinion and judgment on the grounds that: (1) as an aider and abettor, petitioner could not be subject to the private action under § 10(b) of the 1934 Act and SEC Rule 10b-5 promulgated thereunder; and (2) if aiders and abettors are liable under § 10(b), petitioner should not be liable for recklessness, even if it actively and substantially assisted a fraudulent scheme, unless it had owed a preexisting duty to the victims of the fraud. Respondents disagree.

Secondary liability for aiding and abetting would have been provided for had Congress included an express private remedy under § 10(b). With the collapse of this country's financial markets in 1929, Congress enacted the Securities Act of 1933 and the Securities and Exchange Act of 1934 in large part as a determined response to perceived shortcomings of the common law of deceit. Congress would not have excluded from the "catchall" anti-fraud provision of the 1934 act an aiding and abetting remedy already recognized by the common law. Civil liability for aiding and abetting is consistent with

[4] The decision below is *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992), *cert. granted*, 113 S. Ct. 2927 (1993). J.A. 183-213.

the language of § 10(b), and with the purpose and structure of the federal securities laws.

Over the past three decades, hundreds of federal court opinions have unanimously upheld and applied civil aiding and abetting as a vital, integral component of the 10b-5 remedy. Subsequent Congresses have endorsed this judicial interpretation and have effectively ratified the private aiding and abetting action. These affirmations reinforce the conclusions from the language and history of the securities Acts. Without unacceptable damage to congressional intent and to the jurisprudence of § 10(b), secondary liability may not be severed away from the 10b-5 action as a whole.

The 1934 Congress intended that "scienter," the requisite state of mind for both primary violations and aiding and abetting, would encompass reckless conduct. In addition to being fully congruent with the congressional purpose inferable from the statutory language and policy, the recklessness standard is supported by a consistent history of application in the common law. The common law of deceit, which Congress invoked in § 10(b)'s proscription against "deceitful" conduct, made recklessness actionable both for primary fraud and for aiding and abetting. A recklessness standard under the aiding and abetting remedy serves the congressional purpose to move decisively forward, not backward, from the common law, and is supported by the fact that each of the express remedies in the 1933 and 1934 Acts also reaches reckless behavior.

The necessary state of mind for the knowledge or scienter element of the aiding and abetting remedy should remain constant, without regard to the defendant's fiduciary duties. The 1934 Congress nowhere provided for a shifting scienter requirement based on fiduciary duty, either in the language of § 10(b) or elsewhere in the federal securities laws. Petitioner's proposed "duty/no duty" test bears no rational relation to the evidence of congressional intent.

Moreover, that proposed test ignores the principle that, totally apart from duties to act or to disclose, a party is responsible for the consequences when it actively assists wrongdoing. Central Bank was not an unwitting outsider which suddenly found itself innocently at the margins of a securities violation. When Central moved recklessly to thwart review of an appraisal whose serious risks to investors it had earlier identified and confirmed, it was a culpable actor, not a bystander. Having chose to act, Central Bank's 10b-5 liability and its requisite state of mind could no longer depend upon arguments over whether initially it may or may not have had a duty to Act.

ARGUMENT

I. LIABILITY FOR AIDING AND ABETTING SECURITIES FRAUD FALLS SQUARELY WITHIN THE CONTOURS OF THE § 10(b) PRIVATE ACTION AS FRAMED BY CONGRESSIONAL INTENT AND BY THIS COURT'S DEVELOPED § 10(b) JURISPRUDENCE

It is not surprising that after three decades of its delineation and acceptance in the lower federal courts, aiding and abetting liability was neither challenged by Central Bank nor raised by the Tenth Circuit in this case. Respondents agree with the Tenth Circuit and with the other lower federal courts that the aiding and abetting remedy is an integral, and vital, element of the 10b-5 private action.

A. The Private § 10(b) Remedy Must Conform To The Contours Which Would Have Been Shaped By The 1934 Congress; Aiding And Abetting, Like Contribution, Is An Appropriate And Essential Increment Of The § 10(b) Action

The variously elaborated theme of petitioner is that the 1934 Congress never intended civil aiding and abetting under § 10(b), because Congress did not explicitly create a private remedy. It is too late, however, to purport to analyze the issues in the present case from an assumption

that the 1934 Congress was antithetical to the private right of action recognized by this Court.[5]

The working presumption that the 1934 Congress intended the private remedy is followed by the corollary that Congress would have crafted § 10(b) liability as a whole, providing at least for such integral elements as a statute of limitations, a right to contribution and, here, secondary liability. *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. at 2089-90 (1993) (contribution); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 at 2778 (statute of limitations). Given this presumption, the "task is . . . to attempt to infer how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act." *Musick*, 113 S. Ct. at 2089-90; *Lampf*, 111 S. Ct. at 2780.

For the most part, petitioner eschews this test, and contends instead that aiding and abetting should be analyzed under the Court's post-1975 test for previously unrecognized implied actions. *Cort v. Ash*, 422 U.S. 66 (1975). This approach, however, would improperly disassemble § 10(b), applying the pre-1975 test to components addressed by the Court before 1975 and applying the post-1975 test to the parts addressed thereafter. Such a method could only lead to a hodgepodge of inconsistent rules of law, unnecessarily complicating the already complex jurisprudence of § 10(b) and Rule 10b-5. *Musick* provides the correct approach, analyzing whether aiding and abetting as an increment of § 10(b) liability is con-

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[5] As early as 1971, in the first case to come before the Court under the Rule, the Court was satisfied with Justice Douglas's simple statement: "It is now established that a private right of action is implied under § 10(b)," *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971). In 1983, the Court referred to the private civil action as "simply beyond peradventure." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983).

sistent with the probable design of the private action by the 1934 Congress. Given, as the Court held in *Musick*, that Congress would have afforded, to the perpetrators of a fraudulent scheme, legal recourse against others who may have "contributed" to five percent or ten percent of the wrongdoing, would not Congress also have made available to the victims of that scheme legal recourse against those who actively assisted the fraud? Respondents believe that the answer provided by the language and history of § 10(b) is squarely in the affirmative.

B. The 1934 Congress Would Have Intended The 10b-5 Action To Include An Aiding And Abetting Remedy

The congressional design for the 10b-5 remedy must be inferred from the language, history, statutory structure, and legislative purposes of § 10(b), and from analogous provisions of the 1933 and 1934 Acts. *Musick*, 113 S. Ct. at 2089-91. All of these sources support the private action for aiding and abetting.

In 1934, Congress confronted what would become a decade-long national economic depression, in large part induced by the ruin of the Republic's financial markets. Congress had begun the process of enacting comprehensive securities legislation to restore public confidence in the market, by mandating full disclosure and by taking other steps to bring under control rampant securities fraud and manipulation. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963).[6] One such

[6] In *Capital Gains*, Justice Goldberg wrote:

> The Investment Advisors Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. It was preceded by the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. A fundamental purpose, common to these

step was the enactment of the prohibitions of § 10(b), which, through existing statutes, made aiding and abetting a crime. Presuming that Congress had provided a civil remedy, Congress would have intended that civil remedy to reach aiding and abetting as well.

1. *Congress Intended § 10(b) to Extend to a Wide Range of Culpable Conduct by a Broad Class of Defendants*

Petitioner maintains that because the words "aiding and abetting" do not appear in the text of § 10(b), Congress did not intend that statute to extend to those who culpably assist the carrying out of a fraudulent scheme. When § 10(b) was enacted, criminal liability for aiding and abetting offenses against the United States was already provided in the general criminal aiding and abetting statute. *See* Act of March 4, 1909, ch. 321, § 332, 35 Stat. 1152 (formerly 18 U.S.C. § 550).[7] These federal offenses included violation of the criminal section of the 1934 Act, which in turn applied to the other provisions of the Act, including § 10(b) and Rule 10b-5. Securities Exchange Act § 32, 15 U.S.C. § 78ff (1988). No one disputes that the prohibitions of § 10(b) have given rise to criminal aiding and abetting since the promulgation of Rule 10b-5 in 1942. *See, e.g., United States v. Gleason*, 616 F.2d 2 (2d Cir. 1979), *cert. denied*, 444

> statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, "It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail" in every facet of the securities industry.

Ibid. (quoting *Silver v. New York Stock Exch.*, 373 U.S. 341 (1963)) (footnotes omitted).

[7] Today, the statute broadly provides that "[w]hoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission is punishable as a principal." 18 U.S.C. § 2(a) (1988).

U.S. 1082 (1980). It would be anomalous to infer that Congress, having made aiding and abetting securities fraud a crime, would have immunized aiders and abettors from civil liability under the private action.

To the contrary, the language of § 10(b) manifests a congressional purpose to reach an expansive category of wrongdoers and of wrongdoing. Specifically, § 10(b) provides comprehensively that:

> It shall be unlawful for *any person,* directly or *indirectly* by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1988 & Supp. III 1991) (emphasis added).[8]

[8] Pursuant to § 10(b), in 1942 the Commission enacted Rule 10b-5, which provides:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

[Continued]

The phrase "unlawful for any person," underscores that § 10(b) does apply, and was intended to apply, to a broad class of defendants. Inclusion of those who act "indirectly" suggests a legislative purpose fully consistent with the prohibition of aiding and abetting. *See,* Elizabeth Sager, Note, *The Recognition of Aiding and Abetting in the Federal Securities Laws,* 23 HOUS. L. REV. 821, 846 (1986) (aiding and abetting is consistent with liability for "those who only 'indirectly' employ 'manipulative or deceptive' practices"). The language of § 10(b) supports a congressional intention to remedy and to deter not just primary wrongdoing but complicity as well.[9]

2. *Congress' Undoubted Purpose To Fortify Existing Protections Against Securities Fraud Requires the Existence of Civil Aiding and Abetting Under § 10(b), Just to Keep Pace with the Common Law of Deceit*

Unlike the right of contribution recognized by the Court in *Musick,* civil aiding and abetting was already well-established when Congress enacted § 10(b) and had been frequently applied to common law fraud and deceit.[10]

[8] [Continued]

17 C.F.R. § 240.10b-5 (1992). Nothing in the language of the Rule suggests that the Commission intended to preclude or restrict aiding and abetting liability. Indeed, the Commission has long enforced Rule 10b-5 against aiders and abettors, both in administrative actions and in civil injunctive proceedings. *See, e.g., Batten & Co. v. SEC,* 345 F.2d 82 (D.C. Cir. 1964); *SEC v. Spectrum, Ltd.,* 489 F.2d 535 (2d Cir. 1973).

[9] The private action for aiding and abetting is also consistent with the congressional intent reflected by the words "manipulative" and "deceptive" in § 10(b). As a form of secondary liability, aiding and abetting includes the prohibited "manipulative" or "deceptive" conduct through the underlying primary violation. Aiding and abetting is an "indirect" method of effecting a "manipulative or deceptive device or contrivance."

[10] While aiding and abetting also may have criminal law antecedents, the tort law background of the elements of the aiding-

See, e.g., Virtue v. Creamery Package Mfg. Co., 123 Minn. 17, 40, 142 N.W. 930, 939 (1913) (following "well-recognized" rule that all who actively participate in a tort, or who "aid, or abet its commission," are "jointly and severally liable therefor"); *White v. Moran*, 134 Ill. App. 480, 491-92 (1907) (finding persons *in pari delicto* with primary violator if they had actual "or constructive knowledge" of fraudulent character of enterprise and "aided and abetted in its furtherance.").[11]

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abetting doctrine extends back at least to the mid-1800's, *see, e.g. Prince v. Flynn*, 12 Ky. 240, 243-44 (1822); *Clark v. Bales*, 15 Ark. 452, 458 (1849); *Northern Trust Co. v. Palmer*, 171 Ill. 383, 49 N.E. 553, 555 (1898), and supplies a more logical resource from which to determine the intent of the 1934 Congress regarding the contours of the private § 10(b) action. *See* Brief for Petitioner at 28; William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws—Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 14 J. CORP. L. 313, 328 (1988). The punitive purposes of the criminal law diverge materially from the primary goal of the civil aiding and abetting doctrine to apportion responsibility for harm. Kuehnle, *supra*, at 322-23.

[11] *See also Cross v. Sylvia Silk Co.*, 222 App. Div. 134, 136, 225 N.Y.S. 552, 554 (N.Y. App. Div. 1927) (civil aiding and abetting based on fraud); *McClung v. Watt*, 190 Cal. 155, 161, 211 P. 17, 20 (1922) (same); *Fink v. Weisman*, 129 Cal. App. 305, 18 P.2d 961, 965 (1993); *Duguid v. Coldsnow*, 76 Ind. App. 545, 549-50, 132 N.E. 659, 660 (1921) (same); *Raasch v. Lund Land Co.*, 103 Neb. 157, 162, 170 N.W. 836, 838 (1919) (same); *Ft. Myers Dev. Corp. v. J.W. McWilliams Co.*, 122 So. 264, 268 (Fla. 1929) (same); *Svalina v. Saravana*, 341 Ill. 236, 248, 173 N.E. 281, 286 (1930) (same); *Barker v. Fordville Land Co.*, 264 Mich. 95, 249 N.W. 491, 492 (1933) (same); *Leimkuehler v. Wessendorf*, 323 Mo. 64, 97-98, 18 S.W.2d 445, 453 (1929) (same); *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 348, 66 N.W. 399, 400 (1896) (same); 1 THOMAS M. COOLEY, A TREATISE ON THE LAW OF TORTS OR THE WRONGS WHICH ARISE INDEPENDENTLY OF CONTRACT § 85, at 273 (4th ed. 1932) ("All who actively participate in any manner in the commission of a tort, or who command, direct, advise, encourage, aid or abet its commission are jointly and severally liable therefore."); RESTATEMENT OF TORTS § 876(b) (1939).

Because the 1934 Congress is presumed to have been aware of developments in the common law which it intended to buttress, *see Capital Gains*, 375 U.S. at 195, it would neither have scaled back nor, even less likely, excluded aiding and abetting (and other existing forms of secondary liability) from the general anti-fraud provision of the 1934 legislation. *See Herman & MacLean v. Huddleston*, 459 U.S. 390, 388-89 (1983) (important purpose of the federal securities statutes was to "rectify perceived deficiencies" of common-law protections by establishing "higher standards of conduct in the securities industry."); *Basic Inc. v. Levinson*, 485 U.S. 224, 244 n.22 (1988) (10b-5 actions in part designed to "add to the protections provided investors by the common law."); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310-11 (1985) (altering common-law *in pari delicto* doctrine to broaden class of plaintiffs entitled to § 10(b) recovery); *cf. Franklin v. Gwinnett County Public Schools*, 112 S. Ct. 1028, 1035-36 (1992) (presuming that legislature intended implied remedies under Title IX of Education Amendments of 1972 to be at least as expansive as the then current state of the common law).

3. *Analogous Provisions of the 1934 Act also Are Consistent with a Private Remedy for Aiding and Abetting*

Express private remedies found elsewhere in the 1934 Act, are additional sources from which to infer how Congress would have defined the 10b-5 remedy. *Musick*, 113 S. Ct. at 2090-91; *Lampf*, 111 S. Ct. at 2780-81. The Court has twice held that §§ 9 and 18 of the 1934 Act are the closest to § 10(b) in purpose and effect, and thus the most instructive. *Musick*, 113 S. Ct. at 2090-91; *Lampf*, 111 S. Ct. at 2780-81.

The design of §§ 9 and 18 support the 10b-5 private remedy. As with § 10(b), violations of §§ 9(a)-(c) give rise to criminal liability for aiding and abetting through the criminal aiding and abetting statute. *See, e.g., United States v. Shindler*, 13 F.R.D. 292, 294 (S.D.N.Y. 1952).

The SEC has also brought aiding and abetting actions under § 9. *See SEC v. Militano*, 773 F. Supp. 589, 594-95 (S.D.N.Y. 1991) (applying aiding and abetting in SEC civil action under § 9(a)(2)); *In re Barry L. Lefko*, Exchange Act Release No. 17181, 21 S.E.C. 19, 21 (Sept. 30, 1980) (applying aiding and abetting in SEC administrative action under § 9(a)(2)). The private remedy arises under subsection 9(e), which specifically provides for the civil liability of "any person who willfully participates" in any act or transaction in violation of §§ 9(a)-(c). 15 U.S.C. § 78i(e) (1988 & Supp. III 1991); *see Walck v. American Stock Exch.*, 565 F. Supp. 1051, 1064 (E.D. Pa. 1981) (applying aiding and abetting in private action under § 9(e), but finding insufficient factual basis), *aff'd*, 687 F.2d 778 (3d Cir. 1982), *cert. denied*, 461 U.S. 942 (1983).

Section 18, while not containing an explicit aiding and abetting provision, also by its terms extends past primary wrongdoing, to reach the civil liability of those who knowingly make or "cause to be made" misleading statements. *See In re Equity Funding Corp. of Am. Sec. Litig.*, 416 F. Supp. 161, 179-81 (C.D. Cal. 1976) (applying aiding and abetting in private action under § 18); *In re Investors Funding Corp of New York Sec. Litig.*, 523 F. Supp. 533, 542 (S.D.N.Y. 1980) (same); *In re Caesars Palace Sec. Litig.*, 360 F. Supp. 366, 386 (S.D.N.Y. 1973) (same).

Even without including specific "aiding and abetting" language, it is likely that the 1934 Congress presumed that such liability would apply under the express private remedies. *Cf. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 394 (1982) (holding that the secondary liability of conspirators "necessarily follows" from the finding of an implied right of action under the Commodity Exchange Act). Indeed, before enactment of the federal criminal statute in 1909, even federal criminal aiding and abetting, with all of its potentially grave individual consequences, had already been implied by the

common law. *See United States v. Martin*, 176 F. 110, 113-14 (N.D. Iowa 1910).

Petitioner maintains that the 1934 Congress may be seen to have excluded other forms of secondary liability, such as aiding and abetting, simply because it enacted "controlling person" liability under § 20 of the 1934 Act (which applies directly to civil liability under § 10(b)) and under § 15 of the 1933 Act. 15 U.S.C. §§ 77o & 78t (1988). The legislative history refutes this speculation. Congress enacted § 15 of the 1933 Act and § 20 of the 1934 Act to provide a novel mechanism of secondary liability, not present in the common law and especially suited to the securities marketplace, where parties who would otherwise be culpable might escape accountability by operating from behind the scenes.[12] There is no persuasive basis to extrapolate from these provisions a sup-

[12] Nothing in the legislative history of these sections suggests that Congress ever intended them to be preemptive of all, or any, other forms of secondary liability. The "controlling person" legislation aimed specifically to prevent the use of "dummies" to avoid personal responsibility. *See* Nancy C. Staudt, Note, *"Controlling" Securities Fraud: Proposed Liability Standards for Controlling Persons Under the 1933 and 1934 Securities Acts*, 72 MINN. L. REV. 930, 934-39 (1988) (describing legislative history of § 15 of the 1933 Act and § 20 of the 1934 Act). The proposed legislation, defined a "dummy" as "a person who holds legal or nominal title to any property but is under moral or legal obligation to recognize another as the owner thereof." S. 875, 73d Cong., 1st Sess., 77 CONG. REC. 2979 (May 8, 1933), *reprinted in* 1 J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, Item 8 (1973) [hereinafter LEGISLATIVE HISTORY]; *see also Federal Securities Acts: Hearings on H.R. 4314 Before the House Interstate and Foreign Commerce Committee*, 73d Cong., 1st Sess. 122 (1933) (statement of Rep. Parker) (concerned that persons controlling a corporation committing securities fraud might seek to evade liability by appointing directors without actual authority to direct or manage corporate affairs), *reprinted in* 2 LEGISLATIVE HISTORY, *supra*, Item 20.

posed congressional intent to erase other forms of common law secondary liability.[13]

Petitioner also maintains that no right of action for aiding and abetting need be recognized because Congress "decided" not to enact amendments proposed in 1957, 1959 and 1960 that would, among other things, have included within § 20 an express aiding and abetting remedy for SEC injunctive actions. Brief, pp. 20-22. However, as this Court has stated, or perhaps understated, "unsuccessful attempts at legislation are not the best guides to legislative intent." *Red Lion Broadcasting Co. v. FCC,*

[13] The First, Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and Tenth Circuits have held that controlling person liability is intended to supplement, not to supplant existing forms of secondary liability. *See, e.g., In re Atlantic Fin. Management, Inc. Sec. Litig.*, 784 F.2d 29, 33 (1st Cir. 1986), *cert. denied sub nom, AZL Resources, Inc. v. Margaret Hal Foundation*, 481 U.S. 1072 (1987); *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 812 (2d Cir. 1975); *Johns Hopkins Univ. v. Hutton*, 297 F. Supp. 1165, 1211-12 (D. Md. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1124, 1130 (4th Cir. 1970); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118-19 (5th Cir. 1980); *Holloway v. Howerdd*, 536 F.2d 690, 694-95 (6th Cir. 1976); *Fey v. Walston & Co.*, 493 F.2d 1036, 1051-52 (7th Cir. 1974); *Commerford v. Olson*, 794 F.2d 1319, 1323 (8th Cir. 1986); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-77 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1621 (1991); *Kerbs v. Fall River Indus.*, 502 F.2d 731, 740-41 (10th Cir. 1974); *see also* John Musewicz, *Vicarious Employer Liability and Section 10(b): In Defense of the Common Law*, 50 GEO. WASH. L. REV. 754, 789-90 (1982) (1934 Act's scheme and legislative history "strongly supports a conclusion that section 20(a) was meant to supplement rather than replace common-law employer liability"); William Seiter, Comment, *Rule 10b-5 and Vicarious Liability Based on Respondeat Superior*, 69 CAL. L. REV. 1513, 1527 (1981) legislative history does not indicate a congressional intent to preclude the imposition of employer liability without fault). The Third Circuit similarly agrees in general terms since it recognizes aiding and abetting under § 10(b); however, it holds that § 20's "good faith" defense applies even where § 20 overlaps other forms of secondary liability based on lesser culpable states of mind. *See, e.g., Rochez Bros., Inc., v. Rhoades*, 527 F.2d 880, 884-85 (3d. Cir. 1975).

395 U.S. 367, 381-82, n.11 (1969). The principle surely applies here, since Congress was neither addressing, nor was it asked to address, the private action for aiding and abetting; nor did Congress express any intent to restrict the 10b-5 remedy.[14]

In contrast to the remote and ambiguous legislative history on which petitioner relies, other Congresses have directly and specifically expressed their approval of the aiding and abetting action. For example, prior to enacting the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, the 1983 Congress "endors[ed] the judicial application of the concept of aiding and abetting liability to achieve the remedial purposes of the securities laws." H.R. REP. No. 355, 98th Cong., 2d Sess. 10 & n.17 (1983). That this endorsement comprehended the private 10b-5 action is confirmed by a direct citation, in the House Report, to the Second Circuit's decision applying the 10b-5 remedy in *Rolf v Blyth, Eastman Dillon*

[14] The legislative history reflects that "the purpose of the unadopted aider and abettor amendments was 'to strengthen and clarify the injunctive power' rather than to add a new element to the power of the SEC." *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 677-80 (N.D. Ind. 1966) (quoting S. REP. No. 1757, 86th Cong., 2d Sess. 8 (1960)), *aff'd*, 417 F.2d 147 (7th Cir. 1969); *see also Hearings on S. 1178-1182 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 86th Cong., 1st Sess., at 276, 335 & 54 (1959) (amendment merely intended to clarify SEC's injunctive power against aiders and abettors). Ultimately, Congress may not have enacted these provisions because of a view that they were an unnecessary codification of existing law, or simply because the 86th Congress ran out of time. *See Brennan*, 259 F. Supp. at 680 ("[p]erhaps Congress did not act on the reported bills" because "the committee considered such codification unnecessary"); LOSS, SECURITIES REGULATION, 205-260 n.80 (2d ed. 1961) (" 'Recognizing the short time remaining in the 86th Congress to insure legislation by both bodies, the committee was forced to postpone consideration of controversial amendments originally proposed by the Commission.' " (quoting 106 CONG. REC. 14,500 (daily ed. July 2, 1960)).

[Continued]

& Co., 570 F.2d 38 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978). *Ibid.*

In summary, the efforts of the 1934 Congress to strengthen and vitalize common-law fraud doctrines (which had already accommodated a civil remedy for aiding and abetting), the context of existing criminal aiding and abetting liability under the statute, the language of § 10(b), and the expansive remedies, together point directly to the conclusion that the 1934 Congress would have affirmed, rather than precluded, the accountability of parties who aid and abet violations of the 1934 Act and Rule 10b-5.

C. When It Comprehensively Amended The Federal Securities Laws In 1975, Congress Left § 10(b) Intact And Thus Ratified The Aiding And Abetting Remedy

In 1975 Congress comprehensively amended the federal securities laws, leaving undisturbed the provisions under which the federal courts had implied the aiding and abetting remedy. In *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983), the Court described the 1975 legis-

[14] [Continued]

Furthermore, eventually Congress *did* enact SEC enforcement provisions against aiding and abetting in 1964, 1975, 1986 and 1990. *See* Brief for Petitioner at 23. Petitioner argues, in the alternative and without any support from the legislative history, that the failure of *these* Congresses to enact an express private remedy for aiding and abetting somehow demonstrates legislative opposition to the private remedy. The facts are exactly contrary to this hypothesis. When the first of these provisions was enacted in 1964 it was only reasonable for Congress to leave the development of implied private rights to the judiciary. *See Cannon v. University of Chicago*, 441 U.S. 77, 718 (1979) (Rehnquist, J., concurring) ("Cases such as *J.I. Case Co. v. Borak, supra*, [which was decided in 1964,] and numerous cases from other federal courts, gave Congress good reason to think that the federal judiciary would undertake this task."). By 1975, the private remedy for aiding and abetting was well-recognized by the judiciary and Congress. *See infra* text pp. 22-26 and notes 17 & 19.

lation as "the 'most substantial and significant revision of this country's federal securities laws since the passage of the Securities Exchange Act in 1934.'" *Id.* at 384-85 (quoting *Securities Acts Amendments of 1975: Hearings on S. 249 before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess., 1 (1975)).

At the time of these sweeping amendments, the private aiding and abetting remedy had been judicially identified for at least 13 years, since *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963), and had roots as old as the private § 10(b) action itself.[15] By 1975, a private action for aiding and abetting had been upheld by each of the six federal courts of appeal to have addressed it, namely, the Second, Third, Fifth, Seventh, Ninth and Tenth Circuits. *See, e.g., Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973); *Landy v. FDIC*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970); *Brennan v. Midwestern United Life Ins. Co.*, 417 F.2d 147 (7th Cir. 1969); *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971); *Kerbs v. Fall River Indus.*, 502 F.2d 731 (10th Cir. 1974). Aiding and abetting also had been recognized by district courts in the First, Fourth, Sixth and Eighth Circuits. *See, e.g., Bronner v. Goldman*, 236 F. Supp. 713 (D. Mass. 1964), *aff'd*, 361 F.2d 759 (1st Cir.), *cert. denied*, 385 U.S. 933 (1966); *Sohns v. Dahl*, 392 F. Supp. 120 (W.D. Va. 1975); *Holloway v. Howerdd*, 377 F. Supp. 754, 763 (MD. Tenn. 1973), *aff'd*, 536 F.2d 690 (6th Cir. 1976); *Anderson v. Francis I. Dupont & Co.*, 291 F. Supp. 705, 709 (D. Minn. 1968).[16]

[15] *See, supra* note 11, and, *infra* note 20.

[16] *See also Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963); *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 680 (N.D. Ind. 1966); *Robbins v. Banner Indus.*, 285 F. Supp. 758, 761 (S.D.N.Y. 1966); *Fischer v. Kletz*, 266 F. Supp. 180, 190 (S.D.N.Y. 1967); *Ross v. Licht*, 263 F. Supp. 395, 410 (S.D.N.Y. 1967); *Brennan v. Midwestern United Life*

Because judicial recognition of civil aiding and abetting under § 10(b) and Rule 10b-5 was both established and unanimous by 1975, Congress' enactment of the 1975 amendments fully justifies the interpretive canon that Congress ratified the judicial interpretation by leaving intact the statute under which it had been invoked. *See, e.g., Herman & MacLean v. Huddleston,* 459 U.S. 375, 385-86 (1983) ("When Congress acted, federal courts had consistently and routinely permitted a plaintiff to proceed under § 10(b) even where express remedies were available. In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran,* 456 U.S. 353, 381-82 (1982) (comprehensive 1974 amendment of Commodity Exchange Act left intact statutory provisions under which implied cause of action had become part of "contemporary legal context," thus evidencing that "Congress affirmatively intended to preserve that remedy." (citation omitted)); *Lorillard v. Pons,* 434 U.S. 575, 580-81 (1978) (respecting right to jury trial in Age Discrimination in Employment Act, Congress is "presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change." (foonote omitted)); *NLRB v.*

Ins. Co., 286 F. Supp. 702, 728 (N.D. Ind. 1968); *Wasnowic v. Chicago Bd. of Trade,* 352 F. Supp. 1066, 1070 (M.D. Pa. 1972), *aff'd,* 491 F.2d 752 (3d Cir. 1973), *cert. denied,* 416 U.S. 994 (1974); *Robinson v. Penn Central Co.,* 58 F.R.D. 436, 441 (S.D.N.Y. 1973); *Green v. Jonhop, Inc.,* 358 F. Supp. 413, 419 (D. Or. 1973); *In re Caesars Palace Sec. Litig.,* 360 F. Supp. 366, 387 (S.D.N.Y. 1973); *Gold v. DCL Inc.,* 399 F. Supp. 1123 (S.D.N.Y. 1973); *Lewis v. Marine Midland Grace Trust Co.,* 63 F.R.D. 39 (S.D.N.Y. 1973); *Gordon v Burr,* 366 F. Supp. 156, 163-64 (S.D.N.Y. 1973), *aff'd in part, rev'd in part,* 506 F.2d 1080 (2d Cir. 1974); *Ingenito v. Bermec Corp.,* 376 F. Supp. 1154, 1165 (S.D.N.Y. 1974); *Bienewski Ltd. Partnership v. Tising,* 63 F.R.D. 360 (E.D. Wis. 1974); *In re Republic Nat. Life Ins. Co.,* 387 F. Supp. 902, 905-06 (S.D.N.Y. 1975); *Muth v. Dechert, Price & Rhoads,* 391 F. Supp. 935, 938 (E.D. Pa. 1975); *Mitzner v. Cardet Intern., Inc.,* 394 F. Supp. 1119, 1122-23 (N.D. Ill. 1975).

Guillet Gin Co., 340 U.S. 361, 365-66 (1951); George Brunnelle, *A "Contemporary Legal Context" Analysis of Aiding and Abetting,* 11 SEC. REG. L.J. 182, 187 (1983) (Under the *Huddleston* test, "a private right of action for aiding and abetting under Rule 10b-5 was either ratified or created by Congress' 1975 toleration of the theory.").

That the 1975 Amendments effected a ratification of the aiding and abetting remedy is just as compelling as the ratification which the Court found in *Huddleston.* There, the Court concluded that Congress had ratified the judicially developed rules allowing § 10(b) liability to "overlap," in part, the express remedy under § 11 of the 1933 Act. 459 U.S. at 384-86. Relying on holdings from the Second, Fifth, Seventh, Ninth and Tenth Circuits and the District of Massachusetts, the Court observed that although this doctrine had had an uncertain start, it was almost uniformly accepted by 1975. *Id.* at 385 n.21. In the present case, aiding and abetting was at least as "uniform and well understood" as the overlap rule recognized in *Huddleston,* and was, with at least equal if not greater force, an important part of the "contemporary legal context" of the § 10(b) action. *Huddleston,* 459 U.S. at 385-86; *Merrill Lynch,* 456 U.S. at 380.

There is also more recent, and specific, congressional approval of the aiding and abetting remedy. When Congress enacted in 1988 the Insider Trading and Securities Fraud Enforcement Act (ITSFEA), Pub. L. No. 10-704, the § 10(b) action provided the most significant enforcement tool against insider trading. *See* Jeffrey M. Lamberti, Note, *Insider Trading: Secondary Liability Under the Federal Securities Law—Lawyers Beware,* 38 DRAKE L. REV. 425, 425 (1988-1989). Congress wanted to ensure that the ITSFEA would not be judicially construed to "freeze out" implied remedies [17] or to "affect the avail-

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[17] The Committee on Energy and Commerce refused to create an express private right of action for parties other than contemporaneous traders "to avoid creating an express private cause of action which might have the unintended effect of freezing the law or in any way restricting the potential rights of action which have

ability of any other theories of liability, such as aiding and abetting . . ., in appropriate circumstances." [18] Accordingly, Congress enacted an anti-negative implication clause, providing that "[n]othing in this section shall be construed to limit or condition . . . the availability of any cause of action implied from a provision of [the 1934 Act]." 15 U.S.C. § 78t-1(d) (1988).[19]

These congressional enactments, effectively ratifying the private remedy in 1975 and then, in 1988, taking additional steps to assure its continuing integrity, supply an alternative and independent ground for recognizing the aiding and abetting action. They are also consistent with the implication of the aiding and abetting action from sources more contemporary to the 1934 Congress.

D. The Remedy In No Way Interferes With Effective Operation Of The Securities Laws; Each Of The Hundreds Of Federal Courts Addressing The Issue Has Recognized A Civil Action For Aiding And Abetting § 10(b) Violations

While Congress over the years has been alert to maintain the vitality of the 1934 Act in the face of evolving challenges to the policies which inform the federal securities laws, it has been the federal courts which have "accepted and exercised the principal responsibility for the continuing elaboration of the scope of the 10b-5 right and the definition of the duties it imposes." *Musick*, 113 S. Ct. at 2089.

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been implied by the courts in this area. Rather, the Committee wanted to give the courts leeway to develop such private rights of action in an expansive fashion in the future." H.R. REP. No. 100-910, 100th Cong., 2d Sess., 27-28 (1988).

[18] H.R. REP. No. 100-910, 100th Cong., 2d Sess., 27 n.23 (1988).

[19] *See also* H.R. REP. No. 100-910, 100th Cong., 2d Sess., 28 (1988) (recognizing implied actions and indicating that the anti-negative implication clause is intended to preserve them); 134 CONG. REC. S17218 (daily ed. Oct. 21, 1988) (statement of Sen. Proxmire) (ITSFEA not intended "to restrict the evolving law on private rights of action").

A result of that judicial process is a history of at least 30 years in which the federal courts have widely accepted and applied the 10b-5 right to hold accountable those who substantially and culpably aid and abet a primary 10b-5 violation.[20] Currently, all twelve circuits have found aiding and abetting civilly actionable under § 10(b).[21] Our research also reflects that federal district courts have so held in no fewer than 309 published decisions where the discussion of a § 10(b) aiding and abetting claim was sufficiently significant to merit reference in the case headnotes. The importance of this acceptance is not merely an issue of "polling" the lower courts, but a pertinent and especially strong indication that the aiding and abetting

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[20] The private action for aiding and abetting under § 10(b) was apparently first recognized as such in *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963), and first analyzed in detail in *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969). However, the underpinnings of the aiding-abetting claim are even older, being essentially contemporaneous with the private right of action itself. One month after Judge Kirkpatrick's seminal decision recognizing the 10b-5 civil action in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), he addressed the scope of brokers' liability in *Fry v. Schumaker*, 83 F. Supp. 476 (E.D. Pa. 1947), holding that a private action could be brought against brokers as joint tortfeasors if they "render[ed] services essential to or participat[ed] in a scheme of fraud." *Id.* at 478. Furthermore, the private right of action as it was first established in *Kardon* expressly extended to conspiracy, another form of implied secondary liability. 69 F. Supp. at 514-15.

[21] *See, e.g., Cleary v. Perfectune, Inc.*, 700 F.2d 774 (1st Cir. 1983); *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980); *Landy v. FDIC*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991); *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975); *Moore v. Fenex, Inc.*, 809 F.2d 297 (6th Cir.), *cert. denied sub nom. Moore v. Frost*, 483 U.S. 1006 (1987); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986); *Stokes v. Lokken*, 644 F.2d 779 (8th Cir. 1981); *Harmsen v. Smith*, 693 F.2d 932 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983); *DBLKM, Inc. v. Resolution Trust Corp.*, 969 F.2d 905 (10th Cir. 1992); *Woods v. Barnett Bank*, 765 F.2d 1004 (11th Cir. 1985); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27 (D.C. Cir. 1987).

remedy in no way "detracts from the effectiveness of the 10b-5 implied action or interferes with the effective operation of the securities laws." *Musick*, 113 S. Ct. at 2091.

While twice reserving its ruling, this Court has suggested that it would recognize aiding and abetting when the issue was properly presented. *Huddleston*, 459 U.S. at 379 n.5; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191 n.7 (1975). In *Huddleston*, the Court cited to *Merrill Lynch, Pierce, Fenner and Smith, Inc. v. Curran*, 456 U.S. 53 (1982), where it had previously explained that secondary liability for conspirators under a section of the Commodity Exchange Act analogous to § 10(b) "necessarily follows" if a private right is implied:

> Having concluded that exchanges can be held accountable for breaching their statutory duties to enforce their own rules prohibiting price manipulation, it *necessarily follows that those persons who are participants in a conspiracy* to manipulate the market in violation of those rules *are also subject to suit* . . . .

Curran, 456 U.S. at 394 (emphasis added); *Huddleston*, 459 U.S. at 379 n.5.

It follows similarly that aiders and abettors are subject to suit under 10b-5. This rule is no more exceptional than the right to contribution recognized in *Musick* and is incremental to the 10b-5 implied right itself. When *Musick* was decided, the right to contribution under § 10(b) was, if anything, less entrenched than the aiding and abetting remedy, and had certainly not been unanimously accepted by the circuits.[22] Nonetheless, the Court found it significant that "the vast majority of the courts

[22] *See, e.g., Chutich v. Touche Ross & Co.*, 960 F.2d 721, 724 (8th Cir. 1992) (finding no right to contribution under § 10(b)); *Robin v. Doctors Officenters Corp.*, 730 F. Supp. 122, 124-25 (N.D. Ill. 1989) (same); *In re Professional Fin. Management, Ltd.*, 683 F. Supp. 1283, 1285-87 (D. Minn. 1988) (same); *Nelson v. Craig-Hallum, Inc.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) 94,500 at 93192-93193 (D. Minn. 1989) (same); *Biben v. Card*, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,512 at 92,331 n.2 (W.D. Mo. 1991) (same).

of appeals and district courts" which had considered the issue had recognized an implied right of contribution. *Musick*, 113 S.Ct. at 2091. Aiding and abetting, more than contribution, has strong roots in the common law. Finally, while contribution may at least arguably dilute the accountability of joint tortfeasors contrary to congressional intent, the aiding and abetting action ensures accountability in schemes violative of the Act.

In summary, consistent support for this cause of action is derived from consulting each of the recognized interpretive resources reviewed above—the language of the statute and the Rule, what the 1934 Congress would have intended based on the common law antecedents of the § 10(b) action, the structure of the express private remedies under the 1934 Act; legislative enactments in 1975 and 1988 which ratified and protected the aiding and abetting remedy; and the comprehensive judicial acceptance of the private cause of action. The very fact that the subject matter here is securities bespeaks an overall approach that recognizes what happened in this country in a number of areas, including securities, during the few years beginning in 1933. This is not to say simply that the SEC statutes as remedial legislation should be liberally construed, but that the courts, to the extent consistent with the words and the purpose of the statutes, should recall the change in this country from *caveat emptor* to protection of the investor. The substance of all of these interpretive sources is that the civil aiding and abetting remedy stands as an integral part of the 10b-5 action itself.

II. RECKLESSNESS ESTABLISHES SCIENTER WHERE AN AIDER AND ABETTOR AS DID CENTRAL BANK IN THIS CASE, ACTS AFFIRMATELY AND SUBSTANTIALLY TO ASSIST A PRIMARY VIOLATION OF § 10(b)

Petitioner contends that the Tenth Circuit should have employed a "high conscious intent" standard, rather than recklessness, in connection with the scienter element of the aiding and abetting claim. For the reasons stated below, petitioner's reckless conduct, particularly under the

stringent test applied by the Tenth Circuit, correctly establishes the culpable state of mind for civil aiding and abetting liability under § 10(b).

A. Recklessness Establishes Scienter For Civil Aiding And Abetting Under § 10(b)

Determining the requisite state of mind for the § 10(b) action requires the same analysis used in discerning its other elements. A key question, therefore, is how the 1934 Congress would have designed the private remedy. *Musick*, 113 S. Ct. at 2089-90. Based on the language of § 10(b), the structure of the 1933 and 1934 Acts, and the common law at the time of enactment of § 10(b), Congress would have understood the scienter requirement to extend to behavior constituting an "extreme departure from the standards of ordinary care."

1. *Scienter Must Be Shown for both Primary Violations and Aiding and Abetting Violations of § 10(b)*

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), after analyzing the language and history of § 10(b), the Court described the culpable state of mind required in civil actions against primary violators of § 10(b) as "scienter." *Id.* at 194. Scienter, the Latin term for "knowingly," must be shown both for primary violations and for aiding and abetting. The Court has so concluded in an SEC enforcement action, where the defendant was alleged to have "violated and aided and abetted violations . . . of § 10(b)," holding that scienter must be shown "regardless of the identity of the plaintiff or the nature of the remedy sought." *Aaron v. SEC*, 446 U.S. 680, 684 & 691 (1980); *see also* Don J. McDermett, Jr., Comment, *Liability for Aiding and Abetting Violations of Rule 10-5: The Recklessness Standard in Civil Damage Actions*, 62 TEX. L. REV. 1087, 1111 (1984) (culpable state of mind for aiding and abetting violations should be the same as the standard for primary violations); *cf. United States v. Feola*, 420 U.S. 671, 687-88 (1975)

(refusing to apply to criminal conspiracy a culpable state of mind more stringent than that required for the underlying crime.).

2. *Had It Expressly Created the Implied Right of Action, the 1934 Congress Would Have Intended Reckless Conduct to Satisfy the Scienter Requirement*

In *Hochfelder*, the Court stated that scienter "refers to a mental state embracing intent to deceive, manipulate, or defraud." 425 U.S. at 194 n.12. Finding no persuasive contrary indication in the statutory language or scheme, the Court suggested that recklessness may constitute scienter under § 10(b) because "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some acts." *Ibid.* However, since it was negligence that was at issue in *Hochfelder*, the Court reserved decision on "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." *Ibid.*[23]

After *Hochfelder*, every federal circuit has concurred that recklessness satisfies the scienter element for primary violations of § 10(b).[24] Similarly, the circuits have

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[23] In the seventeen years since *Hochfelder*, the Court has not ruled whether recklessness establishes scienter. *See Aaron*, 446 U.S. at 686 n.5 (reserving judgment).

[24] *See, e.g., Hoffman v. Estabrook & Co.*, 587 F.2d 509, 516 (1st Cir. 1978); *Rolf v. Blythe, Eastman Dillion & Co., Inc.*, 570 F.2d 38, 44-47 (2d Cir.), *cert. denied*, 439 U.S. 1089 (1978); *Coleco Indus. v. Berman*, 567 F.2d 569, 574 (3d Cir. 1977), *cert. denied*, 439 U.S. 830 (1978); *SEC v. Gotchey*, 981 F.2d 1251 (4th Cir. 1992) (text available on Westlaw), *cert. denied*, 113 S. Ct. 3049 (1993); *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied sub nom. Walter E. Heller & Co. v. First Virginia Bankshares*, 435 U.S. 952 (1978); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1023-24 (6th Cir. 1979); *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977); *Van Dyke v. Coburn Enter., Inc.*, 873 F.2d 1094, 1100 (8th Cir. 1989); *Nelson v. Serwold*, 576 F.2d 1332,

generally agreed that recklessness establishes the scienter or "knowledge" requirement for civil aiding and abetting under § 10(b), in some cases depending upon the presence or absence of various special circumstances.[25] For the reasons stated below, the recklessness standard conforms with the manner in which the 1934 Congress itself would have spelled out this element of the private remedy.

1337 (9th Cir.), *cert. denied*, 439 U.S. 970 (1978); *Hackbart v. Holmes*, 675 F.2d 1114, 1117 (10th Cir. 1982); *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985); *Dirks v. SEC*, 681 F.2d 824, 844-845, n.27 (D.C. Cir. 1982), *rev'd on other grounds*, 463 U.S. 646 (1983).

[25] *See, e.g., Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983) (recklessness standard applied where defendant has duty to disclose); *Rolf v. Blyth, Eastman Dillion & Co.*, 570 F.2d 38, 44-47 (2d Cir. 1978) (applying recklessness standard to aiding and abetting), *cert. denied*, 439 U.S. 1039 (1978); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 780 (3d Cir. 1976) ("requirement of knowledge may be less strict where the alleged aider and abettor derives benefits from the wrongdoing"); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991), *cert. denied sub nom. Schatz v. Weinberg & Green*, 112 S. Ct. 1475 (1992) (non-action case holding that recklessness applies where defendant owes duty to plaintiff); *Woodward v. Metro Bank*, 522 F.2d 84, 95 (5th Cir. 1975) (applying sliding scale scienter requirement to aiding and abetting); *Ackerman v. Schwartz*, 947 F.2d 841, 847 (7th Cir. 1991) ("[I]f [the alleged aider and abettor] acted recklessly, he had the mental state that identifies fraud under . . . [§ 10(b) and Rule 10b-5]."); *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1126 (7th Cir. 1990) (recklessness standard applied), *cert. denied*, 111 S. Ct. 1317 (1991); *Stokes v. Lokken*, 644 F.2d 779, 783 (8th Cir. 1981) (applying recklessness standard without fully defining culpable state of mind); *Levine v. Diamanthuset*, 950 F.2d 1478, 1483 (9th Cir. 1991) (recklessness standard applied); *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 652-53 (9th Cir. 1988) (same), *cert. denied*, 493 U.S. 1002 (1989); *DBLKM, Inc. v. Resolution Trust Corp.*, 969 F.2d 905, 908 (10th Cir. 1992) (applying recklessness standard); *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985) (applying sliding scale test); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 36 (D.C. Cir. 1987) (recklessness applies where defendant violates duty).

a. *The Language of § 10(b) Manifests a Congressional Intent to Prohibit Reckless Conduct, and Rule 10b-5 Reflects a Similar Purpose of the SEC*

Unlike "actual intent," the recklessness standard for scienter encompasses the full range of § 10(b)'s descriptive language, from which the Court in *Hochfelder* derived the culpable state of mind intended by the 1934 Congress. 425 U.S. at 197-206. The Court concluded that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." *Id.* at 198. While "actual intent" clearly meets these criteria, it is not synonymous with them. As the Court expressly noted, "knowing or intentional misconduct" could include recklessness. 425 U.S. at 194 n.12; *see also Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 44 (2d Cir.) (at common law, the word "knowing" included reckless conduct (citing W. PROSSER, THE LAW OF TORTS § 107, at 700 (4th ed. 1971))), *cert. denied*, 439 U.S. 1039 (1978). "Actual malice" and "calculated falsehood," as these words are used in the Court's libel decisions, include "reckless disregard of whether [a defamatory statement] was false or not." *New York Times Co. v. Sullivan*, 376 U.S. 254, 279-80 (1964); *Garrison v. Louisiana*, 379 U.S. 64, 75 (1964); *Curtis Publishing Co. v. Butts*, 388 U.S. 130, 153 (1967). Similarly, the word "willful" (which the Court equated with the word "intentional") as used in the Fair Labor Standards Act of 1938, also includes "reckless disregard." *McLaughlin v. Richland Shoe Co.*, 486 U.S. 128, 133 (1988).[26]

More importantly, the word "deceptive" is itself a term of art referring to the common law tort of deceit (also

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[26] *See also Hazen Paper Co. v. Biggins*, 113 S. Ct. 1701, 1710 (1993) ("willful" within the meaning of § 7(b) of the Age Discrimination in Employment Act of 1967 includes "reckless disregard"); *Trans World Airlines v. Thurston*, 469 U.S. 111, 128-29 (1985) (same).

known as fraud and misrepresentation). Without question, the tort of deceit included reckless behavior, *see* IACPA Brief at 22, and this principle was prominently and repeatedly woven through the common law by the time the 1934 Congress enacted § 10(b).[27]

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[27] *See Cooper v. Schlesinger*, 111 U.S. 148, 155 (1884); *Lehigh Zinc & Iron Co. v. Baumford*, 150 U.S. 665, 673 (1893); *see also Peek v. Derry*, 14 App. Cas. 337 (H.L. 1889); *Simon v. Goodyear Metallic Rubber Shoe Co.*, 105 F. 573, 580-81 (6th Cir. 1900); *Hindman v. First Nat. Bank of Louisville*, 112 F. 931, 944-45 (6th Cir.), *cert .denied*, 186 U.S. 483 (1902); *Einstein, Hirsh & Co. v. Marshall & Conley*, 58 Ala. 153, 163 (1877); *Colvin v. Delaney*, 101 Conn. 73, A. 841, 843 (1924); *Schoefield Gear & Pulley Co. v. Schoefield*, 71 Conn. 1, 18-19, 40 A. 1046, 1051 (1898); *Johnson v. Holderman*, 30 Idaho 691, 694-95, 167 P. 1030, 1031 (1917); *Parker v. Herron*, 30 Idaho 327, 331, 164 P. 1013, 1014 (1917); *Kirkpatrick v. Reeves*, 121 Ind. 280, 282, 22 N.E. 139, 140 (1889); *Diamond v. Peace River Land & Dev. Co.*, 182 Iowa 400, 441, 165 N.W. 1032, 1035 (1918); *Davis v. Central Land Co.*, 162 Iowa 269, 275, 143 N.W. 1073, 1075 (1913); *Hubbard v. Weare*, 79 Iowa 678, 686, 44 N.W. 915, 918 (1890); *Bice v. Nelson*, 105 Kan. 23, 26, 180 P. 206, 207 (1919); *McGuffin v. Smith*, 215 Ky. 606, 612, 286 S.W. 884, 886 (1926); *Richards v. Foss*, 126 Me. 413, 139 A. 231, 232 (1927); *Goodwin v. Fall*, 102 Me. 353, 66 A. 727, 730 (1907); *Cahill v. Applegarth*, 98 Md. 493, 502-503, 56 A. 794, 797 (1904); *Weeks v. Currier*, 172 Mass. 53, 55, 51 N.E. 416, 417 (1898); *Chatham Furnance Co. v. Moffatt*, 147 Mass. 403, 404, 18 N.E. 168, 169 (1888); *Litchfield v. Hutchinson*, 117 Mass. 195, 197-98 (1875); *Beebe v. Knapp*, 28 Mich. 53, 76 (1873); *Bullitt v. Farrar*, 42 Minn. 8, 11, 43 N.W. 566, 567 (1889); *Lynch v. Mercantile Trust Co.*, 18 F. 486, 487-88 (C.C. Minn. 1883); *Vincent v. Corbitt*, 94 Miss. 46, 47 So. 641, 643 (1908); *Luikart v. Miller*, 48 S.W.2d 867, 868 (Mo. 1932); *Miller v. Rankin*, 136 Mo. App. 426, 117 S.W. 641 (Mo. Ct. App. 1909); *Hamlin v. Abell*, 120 Mo. 188, 203, 25 S.W. 516, 519 (1893); *Shackett v. Bickford*, 47 N.H. 57, 65 A. 252, 254 (1906); *Bingham v. Fish*, 86 N.J.L. 316, 319, 90 A. 1106, 1107 (N.J. 1914); *Hadcock v. Osmer*, 153 N.Y. 604, 608, 47 N.E. 923, 924 (1897); *Kountze v. Kennedy*, 147 N.Y. 124, 129, 41 N.E. 414, 415 (1895); *Indianapolis, P.&C.R.R. Co. v. Tyng*, 63 N.Y. 653, 655 (1876); *Dieterle v. Harris*, 66 Okla. 314, 315, 169 P. 873, 874 (1917); *Jackman v. Northwestern Trust Co.*, 87 Or. 209, 170 P. 304, 305 (1918); *Griswold v. Gebbie*, 126 Pa. 353, 363-64, 17 A. 673, 674 (1889); *Stuck v. Delta Land & Water Co.*, 63 Utah 495, 227 P. 791, 795 (1924); THOMAS M. COOLEY, A TREATISE ON THE LAW OF TORTS, § 300, at 598 *et seq.* (3d ed. 1930); FOWLER V. HARPER, A. TREATISE ON THE LAW OF TORTS, § 221 (1933); FRANCES M. BURDICK, THE LAW OF TORTS: A CONCISE TREATISE ON CIVIL LIABILITY FOR ACTIONABLE WRONGS TO PERSON AND PROPERTY, § 391, at 444-45 (4th ed. 1926); FREDERICK POLLOCK, A TREATISE ON THE LAW OF TORTS IN OBLIGATIONS ARISING FROM CIVIL WRONGS IN THE COMMON LAW, at 355, 367-68 (3d ed. 1894).

In promulgating Rule 10b-5, the SEC, too, intended to reach reckless conduct.[28] The Court has observed that at least one, if not two, of the Rule's three subsections are worded broadly enough to extend even to unintentional conduct. *Hochfelder*, 425 U.S. at 212; *Aaron v. SEC*, 446 U.S. 680, 696 (1980). To the extent Rule 10b-5 is ambiguous, the Commission's position that the Rule addresses reckless conduct for both primary violations and aiding and abetting is entitled to substantial weight. *See Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837, 843 (1984); *Chiarella v. United States*, 445 U.S. 222, 226-27 (1980).

b. *The Legislative History of § 10(b) Shows that Congress Intended to Prohibit Reckless Conduct*

Reviewing the legislative history of § 10(b), the *Hochfelder* Court found "an overall congressional intent to prevent 'manipulative and deceptive practices which . . . fulfill no useful function' and to create private actions for damages stemming from 'illicit practices,' *where the defendant has not acted in good faith*." 425 U.S. at 202-206 (emphasis added). The Court concluded that "[t]here is no indication that Congress intended anyone to be made liable for such practices unless he acted other than in good faith. The catchall provision of § 10(b) should be interpreted no more broadly." *Id.* at 206. To find a culpable mental state where a defendant acts 'other than in good faith' requires a considerably more expansive

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[28] For the text of Rule 10b-5, *see supra* note 8.

standard than "high conscious intent." *See Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46 n.15 (2d Cir.) ("Reckless behavior hardly constitutes good faith. Since good faith does not constitute a defense to reckless or intentional conduct, a recklessness standard is fully consistent with *Hochfelder* on its own terms."), *cert. denied*, 439 U.S. 1039 (1978); BLACK'S LAW DICTIONARY 693 (6th ed. 1990) (Good faith requires "[h]onesty of intention, and freedom from knowledge of circumstances which ought to put the holder upon inquiry.").

c. *Recklessness Is Consistent with the Express Private Remedies and with the Structure of the Acts*

The range of circumstances covered by the eight express private remedies at §§ 11, 12 and 15 of the 1933 Act and §§ 9, 16, 18, 20 and 20A of the 1934 Act shows the purpose of Congress to create civil liability for a wide variety of wrongdoing, from strictly liable activity to behavior bereft of good faith such as recklessness. None of these remedies requires a showing higher than recklessness. Section 11 of the 1933 Act makes issuers strictly liable for false or misleading registration statements and provides only a "due diligence" defense for other culpable parties. 15 U.S.C. § 77k (1988). Section 12 of the 1933 Act places the burden of proof on the seller or offeror of a security to show that he or she "in the exercise of reasonable care could not have known" that a prospectus or oral communication was misleading. 15 U.S.C. § 771 (1988). Section 15 of the 1933 Act incorporates a negligence standard, under which controlling persons are civilly liable unless they had no "reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." 15 U.S.C. § 77o (1988).[29] Section 9 of the 1934 Act holds civilly liable anyone who "willfully"—a term which the Court

[29] The Court has already noted that, at a minimum, "each of the express civil remedies in the 1933 Act allow[s] recovery for negligent conduct." *Hochfelder*, 425 U.S. at 208.

has held to comprehend at least recklessness in other statutory contexts[30]—participates in the manipulation of securities prices.[31] 15 U.S.C. § 78i (1988 & Supp. III 1991). Section 16 of the 1934 Act creates strict liability under most circumstances, and a mere "good faith" defense under others. 15 U.S.C. § 78p(2) (1988). Section 18 of the 1934 Act places the burden on persons making misleading statements to prove that they "acted in good

[30] *See, e.g., Hazen Paper Co. v. Biggins*, 113 S. Ct. 1701, 1710 (1993); *McLaughlin v. Richland Shoe Co.*, 486 U.S. 128, 133 (1988); *Trans World Airlines v. Thurston*, 469 U.S. 111, 128-29 (1985).

[31] *See* IX LOSS & SELIGMAN, SECURITIES REGULATION 4282 (3d ed. 1991) (Regarding the word "willfully" in § 9(e), "[o]rdinarily, on the assumption that there is any proof that the defendant participated at all in the manipulation, this requirement should not create much trouble in view of the loose way the courts have interpreted "willfully" even in criminal cases and in broker-deal revocation proceedings under the 1934 Act." (footnote omitted)); *see also Rolf v. Blyth, Eastman Dillion & Co.*, 570 F.2d 38, 46 (2d Cir.) ("Similarly, securities law cases have recognized that recklessness may serve as a surrogate concept for willful fraud."), *cert. denied*, 439 U.S. 1039 (1978). Respecting the use of the word "willfully" in *criminal* contexts, one commentator has explained that the term equates with the common law's general intent, corresponding to recklessness, and not with specific intent:

> The criminal law's ambiguity on the crucial issue of intent spawned an influential reform effort in the form of the Model Penal Code prepared under the auspices of the American Law Institute. . . .
>
> Synonyms for "purposely," sitting at the top level of culpability in the Model Penal Code's descending hierarchy, are "intentionally," "with intent," "design," or "with design." "Willfully," which has been termed "a word of many meanings," is equated with "knowingly," not "purposely." "Purposely" generally correlates with the common law's "specific intent." Both "knowingly" and "recklessly" correspond, according to the Model Code's drafters, with the "the common law requirement of 'general intent.'" The general intent requirement at common law was not a rigorous one.

John P. Freeman, *Scienter in Professional Liability Cases*, 42 S.C. L. REV. 785, 829 (1991) (footnotes omitted).

faith and had no knowledge that such statement was false or misleading." 15 U.S.C. § 78r (1988). Section 20 of the 1934 Act holds controlling persons liable "unless the controlling person acted in good fatih and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a) (1988). Section 20A of the 1934 Act makes insider trading violations civilly actionable without creating a defense based on good faith or some other mental state. 15 U.S.C. § 78t-1 (1988).

Since reckless behavior is civilly actionable under each of the express remedies, the 1934 Congress would have intended an analogous state of mind to establish scienter for aiding and abetting 10b-5 violations. *Cf. In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533, 542 & n.4 (S.D.N.Y. 1980) (recklessness sufficient to prove aiding and abetting under § 18 of the 1934 Act); *SEC v. Militano*, 773 F. Supp. 589 (S.D.N.Y. 1991) (recklessness is sufficient to prove aiding and abetting under § 9 of the 1934 Act). Indeed, Congress made secondarily liable parties civilly responsible for their reckless conduct when it expressly provided for secondary liability under the Acts. Unlike the other private remedies, § 15 of the 1933 Act and § 20 of the 1934 Act are directed exclusively to secondary liability.[32] Congress' creation of liability for reckless behavior of controlling persons under these provisions[33] (including recklessness by persons or parties who control entities that violate § 10(b)) forcefully suggests that Congress also would have intended aiders and abettors to be civilly liable for recklessness under the private § 10(b) remedy.

[32] Petitioner argues against the private action for aiding and abetting under § 10(b) on the ground that secondary liability cannot be based on a primary violation of § 15 of the 1933 Act and § 20 of the 1934 Act. This ignores that these sections involve only secondary liability. There is no reason to suppose that Congress would even have considered providing for a remedy directed to "aiding and abetting of secondary liability."

[33] *See, e.g., Hochfelder*, 425 U.S. at 208 (under § 15 controlling persons are liable for negligent conduct); *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945, 959 (5th Cir. 1981) (§ 20 extends to reckless conduct).

d. *Congress Would Not Have Required Actual or "High Conscious" Intent for Civil Liability, Since this Would Have Confined the 10b-5 Action More Narrowly than the Common Law Remedy*

Reckless conduct was civilly actionable by victims of fraud when the 1934 Congress enacted § 10(b). *See, e.g.*, THOMAS M. COOLEY, A TREATISE ON THE LAW OF TORTS OR THE WRONGS WHICH ARISE INDEPENDENTLY OF CONTRACT § 361, at 603 (4th ed. 1932); *see also* cases cited, *supra* note 27. Similarly with respect to aiding and abetting, rather than requiring a strict showing of actual knowledge, common law courts at the time § 10(b) was enacted had begun imposing aiding and abetting liability based on "constructive knowledge." *See White v. Moran*, 134 Ill. App. 480, 491 (1907) ("If [the alleged aiders and abettors] had actual *or constructive knowledge* of the fraudulent character of the enterprise, and with such knowledge, aided and abetted in its furtherance, and by means of false and untrue representations induced appellee to invest therein, they were *in pari delicto* with White in the fraud and deceit practiced and equally liable with him for any damages occasioned to appellee." (emphasis added)). In a related context, transferees of fraudulent conveyances were liable for their substantial assistance to the fraud, so long as they acted either with actual knowledge, constructive knowledge, or notice of the fraud. *See, e.g., Svalina v. Saravana*, 341 Ill. 236, 250, 173 N.E. 281, 286 (1930) ("even though the grantee pays a valuable, adequate, and full consideration, yet, if the grantor sells for the purpose of defeating the claims of credtiors and the grantee knowingly assists in such fraudulent intent, *or even has notice thereof*, he will be regarded as a participant in the fraud" (emphasis added)); *Beidler*

v. Crane, 135 Ill. 92, 99, 25 N.E. 655, 657 (1890) (even notice of fraudulent transfer makes participant liable, "for the law never allows one man to assist in cheating another"); *Merchant & Farmers' Bank v. Harris*, 113 Ark. 100, 108, 167 S.W. 706, 708 (1914) (grantee "charged with notice [of fraud], . . . must be held to have assisted [the primary wrongdoer] in carrying out his fraudulent purpose"). While some courts applied the "knowledge" element of aiding and abetting without addressing or explaining its scope, the courts which specified that the remedy was applicable to circumstances evidencing absence of good faith should be given special weight. *See* Loss, Fundamentals of Securities Regulations 812 (1963) ("Because of the legislative background it seems reasonable to assume at the very least that the most liberal common law views on these questions should govern under the statutes").[34]

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[34] Petitioner argues that the criminal model should prevail over the civil model for at least the knowledge element of aiding and abetting. This is especially unpersuasive because of the punitive purpose of the criminal law as compared to the compensatory and remedial objectives of the private remedy. As one commentator has noted in support of applying civil, rather than criminal, aiding and abetting principles to the private § 10(b) action:

> The criminal standards for aiding and abetting focus heavily on the intentional nature of the conduct. This is appropriate because *mens rea* is an essential element for criminal liability. Tort liability, on the other hand, merely seeks to apportion responsibility for harm.

Kuehnle, *supra* note 10, at 322-23.

It is, in any event, far from clear that the Court's formulation of the requisite culpable state of mind for criminal aiding and abetting would not also extend to reckless conduct. *See Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949) ("in order to aid and abet another to commit a crime it is necessary that a defendant 'in some sense associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed.'" (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938))); *United States v. Sarantos*, 455 F.2d 877, 880-82 (2d Cir. 1972) (upholding jury instruction basing aiding and abetting liability on a "reckless disregard of the falsity of the statements or a conscious effort to avoid learning the truth"); *United States v. Hughes*, 891 F.2d 597, 600 (6th Cir. 1989) ("reckless disregard" establishes criminal aiding and abetting); Freeman, *supra* note 31, at 833 ("The generally accepted common-law position views recklessness as a sufficient level of criminal intent . . . .").

While the common law remedies for securities fraud cannot be strictly followed, the parameters of § 10(b) must account for any differences. *See Basic Inc. v. Levinson*, 485 U.S. 224, 243-44 (1988); *see also Basic Inc.*, 485 U.S. at 253 (White, J., dissenting) (the common law is a "guidepost" for interpreting § 10(b)). Petitioner and supporting amici are quick to point out that the federal securities laws are "light years away" from their common law antecedents; for precisely that reason, however, it should also be beyond doubt that the 1934 Congress would not have intended its catchall anti-fraud provision to be light years *less* effectual in curbing fraud than the common law. Were victims of unlawful securities schemes to be routinely burdened with the task of proving specific fraudulent intent in complex transactions,[35] often involv-

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[35] It is not unusual in securities fraud cases that parties or experts will resist at every turn, and often in reliance on not particularly meaningful distinctions, plaintiff's effort to prove scienter; a typical example is the following exchange from a discovery deposition of Central Bank's trust officer:

> Q: [Y]ou knew that the real estate market in Colorado Springs was in a state of decline?
>
> A: [CENTRAL BANK TRUST OFFICER CRANDALL] I did not know that. I had been advised that or heard of it and it had been discussed. But I didn't know that.
>
> Q: I'm not an expert on the English language, and I was using the word "knew" or "know" the way we do in common parlance. Who had advised you that the real estate market was in a state of decline?
>
> A: [The Dain Bosworth Representative] had called me and advised me that based on whatever work he had done . . . there was a decline in property values in El Paso County.

J.A. 63-64. Accordingly, the Court has noted that "the difficulty of proving the defendant's state of mind supports a lower standard of proof" in 10b-5 fraud case. *Huddleston*, 459 U.S. at 692 n.30.

ing corporate defendants employing elaborately diffused levels of authority and responsibility, there would be little reason for them to turn from the common law remedies to § 10(b). *See Rolf v. Blyth, Eastman Dillion & Co.*, 570 F.2d 38, 47 (2d Cir.) ("To require in all types of 10b-5 cases that a factfinder must find a specific intent to deceive or defraud would for all intents and purposes disembowel the private cause of action under § 10(b)."), *cert. denied*, 439 U.S. 1039 (1978). The evidence is that the 1934 Congress would not, and did not, intend this result.

B. The Question Of Petitioner's Duty To Act Or To Disclose Is Irrelevant To The Scienter Required For Aiding And Abetting; This Is Particularly The Case Where, As Here, A Defendant Affirmatively Assists A Fraudulent Scheme

Petitioner argues in the alternative that the scienter requirement for aiding and abetting ought to vary or "slide" depending upon a defendant's duty to disclose or act. Petitioner ignores, however, this Court's holdings, most recently in *Musick*, pointing to the importance of how the 1934 Congress would have defined the scienter element of a private right under § 10(b).

Applying that test, it is evident that Congress did not intend scienter as a fluctuating requirement, and would not have so structured the 10b-5 action. A "sliding" knowledge element has no basis in the language or history of § 10(b), nor do any of the express private remedies under the 1933 or 1934 Acts purport to alter the standard for the requisite state of mind depending upon the presence or absence of disclosure duties. There is no reason to suppose that the 1934 Congress would have shaped the 10b-5 private action in this manner when it had failed to do so anywhere else in the federal securities laws.[36]

[36] *Cf.* McDermett, *supra* page 30, at 1108 ("The courts that have limited the application of the recklessness standard in aiding and abetting cases have not stated a clear rationale for requiring a duty to disclose.").

To the contrary, there is substantial reason why the scienter element would *not* have been left vaguely to depend on whether the defendant might ultimately prevail on an argument for "no disclosure duty." This Court has already rejected the idea of overlaying a duty/no duty "distinction" on the materiality element of primary liability. *See Basic Inc. v. Levinson*, 485 U.S. 240, n.18 ("Devising two different standards of materiality, one for situations where insiders have traded in abrogation of their duty to disclose or abstain (or for that matter when any disclosure has been breached), and another covering affirmative misrepresentations by those under no duty to disclose (but under the ever-present duty not to mislead), would effectively collapse the materiality requirement into the analysis of defendant's disclosure duties."). Similarly as to the scienter requirement, the application of a "duty to disclose" standard would collapse that element into an analysis (and almost certainly an elusive one) of disclosure obligations.

Although some courts have identified still other special circumstances as determining the required level of scienter,[37] these matters are in reality not different from the evidentiary factors subsumed within the recklessness standard itself.[38] When incorporated into separate "tests"

[37] A number of lower courts vary the degree of knowledge required for § 10(b) aiding and abetting based on such factors as duty to disclose or to act, whether the aider and abettor's conduct was "outside the daily grist," the proximity of the aider and abettor to the fraud, and the nature of the aider and abettor's alleged wrongdoing. *See, e.g., Cleary v. Perfectune, Inc.*, 700 F.2d 774, 776-79 (1st Cir. 1983) (where assistance is by "inaction and silence," actual knowledge must be shown to support aiding and abetting); *Woodward v. Metro Bank*, 522 F.2d 84, 95 (5th Cir. 1975) ("The scienter requirement scales upward when activity is more remote." (footnote omitted)).

[38] The recklessness standard already permits the finder of fact to weigh any circumstantial evidence of intent when determining

or "sliding" standards, such factors become unworkable and confusing. *See* Freeman, *supra* note 31, at 808-18 (explaining the myriad problems arising from varying the knowledge standard, and suggesting uniform application of recklessness standard); McDermett, *supra* p. 30, at 1111-14 (suggesting a uniform recklessness standard for 10b-5 aiding and abetting).

Even had the 1934 Congress prescribed some circumstances where disclosure duties might condition the availability of the aiding and abetting remedy, petitioner's affirmative role in delaying a correct appraisal of the collateral for the 1988 bonds, when petitioner's own in-house expert had concluded that the appraisal unjustifiably overstated the value of the collateral, makes irrelevant an analysis of preexisting "duties to disclose." Central Bank was an actor, not a passive bystander; a duty arose from that conduct. *See, Ackerman v. Schwartz,* 947 F.2d 841, 848 (7th Cir. 1991) ("Although the lack of duty to investors means that [the alleged aider and abettor] had no obligation to blow the whistle and none to correct a letter he had not authorized to be circulated in the first place . . ., [he] cannot evade responsibility to the extent he permitted the [primary violators] to release his letter." (citations omitted)); *FDIC v. First Interstate Bank of Des Moines, N.A.,* 885 F.2d 423, 432-33 (8th Cir. 1989); *Levine v. Diamanthuset, Inc.,* 950 F.2d 1478, 1485 n.4 (9th Cir. 1991) ("[W]e do not discuss the

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whether the defendant has acted recklessly. Kuehnle, *supra* note 6, at 330. As Mr. Kuehnle suggests:

> [I]nstead of treating recklessness as the appropriate standard only under certain circumstances, at least where assistance is through action, it may be better to state that recklessness generally is appropriate and that the totality of circumstances must be considered to determine whether the aider and abettor had knowledge equivalent to recklessness.

Id. at 330; *see also* Freeman, *supra* note 31, at 844-55 (explaining how various factors are relevant to proving recklessness).

[aider and abettor's duty to disclose] because [its] aiding and abetting liability is premised in part not on silence, but on actual misrepresentations."); *Roberts v. Peat, Marwick, Mitchell & Co.,* 857 F.2d 646, 652-53 (9th Cir. 1988) ("The secondary violator's duty to disclose may arise from a 'knowing assistance of or participation in a fraudulent scheme.'" (quoting *Harmsen v. Smith,* 693 F.2d 932 (9th Cir. 1982), *cert. denied,* 464 U.S. 822 (1983)), *cert. denied,* 493 U.S. 1002 (1989); *Cf. Bateman Eichler, Hill Richards, Inc. v. Berner,* 472 U.S. 299, 313 (1985) (tippee's active participation creates duty); *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 152 (1972) (duty arises under § 10(b) from "active" conduct); W. PROSSER, THE LAW OF TORTS 339 (3d ed. 1964) ("If there is no duty to come to the assistance of a person in difficulty or peril, there is at least a duty to avoid any affirmative acts which make his situation worse when we cross the line into the field of 'misfeasance' liability is far easier to find . . . ."). The requisite state of mind for the liability of a nonfiduciary who actively assists securities fraud should be no different from the culpable mental state of a fiduciary who passively assists securities fraud in violation of a preexisting duty to act or to disclose. *Cf. Aaron v. SEC,* 446 U.S. 680, 695 (1980) (Section 10(b) "applies with equal force to both fiduciary and nonfiduciary transactions in securities.").

In summary, unlike "high conscious intent" or "actual knowledge," recklessness, while itself a stringent standard, does not impose unrealistic burdens of proof upon an already complex private action. Recklessness also has a lengthy, tested history of application and of interpretation in the common law of deceit, and it properly permits consideration by the trier of fact of other circumstances pertinent to determining the defendant's state of mind. The recklessness standard meets fully the criteria for assuring that the design of the 10b-5 aiding and abetting remedy is derived from congressional intent, as that intent is pre-

sented by the language, structure and purposes of the 1934 Act.

CONCLUSION

For the foregoing reasons, the judgment of the Tenth Circuit should be affirmed, and the case should be remanded for trial in the federal district court.

Respectfully submitted,

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